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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98

REPLY COMMENTS OF GTE SERVICE CORPORATION AND ITS AFFILIATED DOMESTIC TELEPHONE OPERATING COMPANIES IN RESPONSE TO SECOND FURTHER NOTICE OF PROPOSED RULEMAKING

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GTE Service Corporation and its affiliated domestic telephone operating companies[1] (collectively "GTE") respectfully submit their Reply Comments in the above-captioned docket.

INTRODUCTION AND SUMMARY

In a statement made just two weeks ago to the Senate Commerce Committee, Chairman Kennard confirmed what GTE explained in its opening comments -- that CLECs are raising billions of dollars in capital and deploying local facilities in markets across the country. As Chairman Kennard reported, there are "now 20 publicly traded CLECs with a total market capitalization of $33 billion," and in "the first quarter of 1999 alone, almost a million CLEC access lines were installed."[2] These facts about the local marketplace square perfectly with

[1] GTE Alaska Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., GTE West Coast Incorporated, and Contel of the South, Inc.

[2] Oral Testimony of William E. Kennard Before the Senate Commerce Committee, at 2 (May 26, 1999).

GTE's own experience, which confirms that CLECs are broadly deploying their own facilities in urban and rural, large and small, markets alike. The drivers of this facilities-based competition -- CLECs like Cox Communications -- counsel the Commission in their comments that "the current broad availability of UNEs and the Commission's pricing methodology actually jeopardize the development of facilities-based competition." Cox Comments at 12.

Nevertheless, the Big Three IXCs and other commenters assert that "serious competition has developed at a snail's pace, and only in a very few business markets." MCI WorldCom Comments at 3. Indeed, the Big Three go so far as to claim "that there are today no remotely adequate substitutes for any of" the network elements identified by the Commission as possible prospects for unbundling, AT&T Comments at 15, and that "nothing that has happened since" 1996 "could rationally give the Commission any optimism about the success of local competition," Sprint Comments at 43-44. The commenters proffering these demonstrably false assertions support them not with actual *facts* about real-world CLECs competing in the local marketplace, but with theoretical *assertions* about the existence of bumps on the road to full-fledged facilities-based competition.

As the Supreme Court made clear, these assertions cannot take the place of actual marketplace facts when the Commission evaluates the "availability of elements outside the incumbent's network." *AT&T Corp. v. Iowa Utils. Bd.*, 119 S. Ct. 721, 735 (1999). Since 1996, the number of CLECs has grown to more than 1,000 -- an increase of 425 percent -- and these CLECs are experiencing rapid revenue growth. *See* Report of Network Engineering Consultants, Inc. at 1 & Exhibit A ("NECI Report") (filed as Appendix B to GTE's Comments). In the last three years, these CLECs have rapidly deployed facilities in markets across the country -- including 600 new switches in markets as small as LaBelle, Missouri -- and tens of thousands of miles of fiber used to provide both interoffice transport and local access. *See* Peter W. Huber & Evan T. Leo, UNE Fact Report at I-1, II-6 ("UNE Fact Report") (submitted with the Comments of USTA). In eight GTE markets that are representative of GTE's local service territories -- ranging from Dallas, Texas to Oxford Junction, Iowa -- 26 different competitors are providing service over their own facilities. *See* Report of PNR & Associates, Inc. ("PNR Report") (filed as Appendix D to GTE's Comments). These GTE competitors self-provide or purchase from non-ILEC sources *every one* of the elements at issue in this proceeding, and self-provide or purchase at wholesale many of the elements -- like switching and transport -- near-uniformly. *Id* at 23. Moreover, the "addressable" market that could be served by these CLECs' *existing* competitive facilities encompasses virtually all of GTE's high-value customers and, in some instances, virtually all of GTE's customers. *See, e.g., id.* at DFW Metroplex 4. Thus, whatever theoretical issues can be identified with employing non-ILEC alternatives, the record is clear that CLECs with actual capital on the line are competing successfully using substitutes for unbundled GTE elements.

The Big Three and other commenters have attempted to lead the Commission down the primrose path by suggesting that it can ignore this extensively documented factual record. Thus, AT&T asserts that the Supreme Court vacated Rule 319 "on an extremely narrow and technical ground" and made it "explicit that it had not remotely called into question the validity of a requirement that incumbent LECs make these seven network elements available to any requesting carrier in the nation." AT&T Comments at 4. This assertion was echoed by others including MCI WorldCom, Sprint, and Qwest -- all of which characterize the "Supreme Court's remand" as "very limited in scope." Qwest Comments at 3; *see also* MCI WorldCom Comments at 2; Sprint Comments at 5. Indeed, AT&T goes so far as to claim that the Commission can comply with the Supreme Court's instructions simply by reinstating -- after making an inconsequential alteration in rationale -- its prior rule that "any increase in the costs to provide service incurred by CLECs that lease network elements will impair their ability to provide service." AT&T Comments at 35.

The Commission should not accept these ill-advised invitations to avoid the work required by the Supreme Court. As GTE stated in its Comments, this proceeding offers the Commission the choice between ensuring that the pace of competition continues to grow or derailing the competitive process by destroying incentives for both ILECs and CLECs to invest in new facilities. This cautionary note was also sounded by facilities-based CLECs like Cox Communications and Focal Communications, which stand the most to lose if competitors are free to purchase ILEC elements -- either alone or in combination -- at prices that manifestly disadvantage CLECs with actual facilities. *See, e.g.,* Cox Comments at 3. The Commission should recognize, as Justice Breyer concluded, that the Act's unbundling standards "require balance," *Iowa Utils. Bd.*, 119 S. Ct . at 754 (Breyer, J., concurring in part and dissenting in part) -- a balance that can be struck if the Commission affords CLECs access to unbundled ILEC elements only where the element is essential to competition and there is convincing *factual* evidence that CLECs cannot effectively compete using substitutes for the element.

REPLY DISCUSSION

I. THE LEGAL AND ECONOMIC STANDARDS THAT GOVERN UNBUNDLING OBLIGATIONS UNDER SECTION 251(d)(2).

A. Overbroad Unbundling Rules Destroy, Not Enhance, Incentives For CLECs and ILECs To Invest in New Facilities. Such Requirements Would Therefore Run Afoul of Section 251(d)(2) and Frustrate the Act's Purpose of Promoting Competition.

It is an elementary principle of economics -- as universal as the law of gravity -- that making an item available at a lower price encourages purchasers to buy that item more frequently and rely less often on substitutes. Likewise, it is an elementary principle of competition that affording firms access to a competitor's property at a price based on an assumption of perfect forward-looking efficiency -- a state that no player in the market can actually achieve -- destroys incentives such competitors have to rely on alternative sources for that input. This outcome is highly anticompetitive because competition is driven by CLEC incentives to improve upon ILEC inputs or find a way to provide service with an alternative input. This development provokes the incumbent to respond in kind, making its own investments to improve upon the service of its competitors. As Professor Kahn states, the "most creative and productive form of competition is innovation -- in the methods of producing and supplying existing products and services and in developing new product and service offerings." Declaration of Alfred E. Kahn at 4 ("Kahn Declaration") (filed as Appendix A to GTE's Comments). This fact was also recognized by Congress, whose express preference for the "deployment" by competitors of new "technologies" underscores the fact that genuine innovation in telecommunications markets depends on investment in facilities. Pub. L. No. 104-104, 110 Stat. 56 (1996); H.R. Conf. Rep. No. 104-458, at 1 (1996).

It is widely accepted among leading economists and antitrust commentators that sharing requirements significantly diminish the incentives for both competitors and incumbents to innovate through investment in their own facilities.[3] Since it is both risky and expensive for CLECs to deploy their own substitute network elements, the safe and easy course, from the perspective of a new entrant, is to avoid that risk by relying entirely on ILEC elements. Imposing mandatory sharing requirements when substitutes are available also undermines the investment incentives of existing players in the market. CLECs who have already deployed their own facilities will be hampered in their ability to compete if other CLECs can secure the same facilities from the ILEC at lower regulated prices. Because a sharing requirement will lower the returns these firms reasonably expected to receive on their investments, their incentive to continue to invest in competitive facilities would be severely diminished.[4] Likewise, ILECs will

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[3] *See* Kahn Declaration at 4 (because "competition and innovation themselves consist in a quest for differential advantage, a requirement that the benefits be shared, on regulatorily dictated terms, in the cases in which that quest has been successful would interfere with the competitive process itself"); 3A Philip E. Areeda & Herbert Hovenkamp, ANTITRUST LAW 174 (1996) ("Areeda & Hovenkamp, ANTITRUST LAW") ("the right to share a monopoly discourages firms from developing their own alternative inputs").

[4] Kahn Declaration at 8 (overbroad sharing requirements "discourage new, risky investment" by "*existing* facilities-based CLECs, which have already invested billions of dollars of their own capital in challenging the historical monopolists and are investing more each year") (emphasis in original).

have diminished incentives to invest in upgrading and improving their own facilities because any such gains would have to be shared with competitors.[5]

Facilities-based CLECs,[6] like Cox Communications, have invested billions in their own networks and will face the most severe competitive disadvantages if competitors are afforded access to ILEC elements that are otherwise available in the marketplace. These commenters agree that a "regulatory regime that fosters the broad availability of incrementally priced UNEs discourages competing carriers from building their own networks and leaves them dependent over the long term on the ILECs, to the detriment of the public interest." Cox Comments at 3. Thus, Cox concludes that the Act's "framework strongly suggests that Congress intended to incent competing telecommunications carriers . . . to build their own facilities and to rely as little as possible on the incumbent's infrastructure." *Id.* at 9. Likewise, WinStar states in its comments that "relying on access to traditional unbundled network elements, in the long run, simply will not result in innovative services nor in a competitive marketplace sustainable other than through the artificial hand of regulation." WinStar Comments at 3.

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[5] MCI WorldCom asserts that the Commission should not consider the deleterious effects its unbundling rules may have on ILEC incentives to innovate because "most of the innovation and high-risk investment that takes place in the telecommunications industry is undertaken by equipment vendors," and because ILECs "do not usually invest large sums of money in high-risk enterprises." MCI WorldCom Comments at 9. This claim reflects the results the Big Three *hope* to achieve in this proceeding -- crippling ILEC incentives to invest in their own networks -- and not the *current* reality of the marketplace. ILECs are, for example, making significant investments in the provision of xDSL service -- although these investments are outpaced by CLECs -- in recognition of the fact that the voice and data markets are rapidly converging. UNE Fact Report at VI-19.

[6] GTE refers to "facilities-based CLECs" as being those competitors that self-supply one or more network elements.

Nevertheless, the Big Three argue that requiring ILECs to unbundle network elements -- even when substitutes are widely available in the marketplace -- actually *enhances* the incentive of CLECs to deploy their own facilities. They assert, for example, that "network elements provide a critical transition to facilities-based competition because they permit entrants to learn aspects of the business, such as their customer's calling volumes and traffic patterns, that will be essential to their subsequent decisions on whether and where to deploy facilities." AT&T Comments at 21. Ultimately, the Big Three go so far as to claim that CLECs can "generate sufficient revenues and customers to warrant the construction of new facilities" "*[o]nly* by being allowed to lease facilities," and therefore that the "availability of unbundled network elements at cost-based rates" is a "*necessary precondition*" to the construction of new facilities. MCI WorldCom Comments at 8 (emphasis added).[7] These commenters thus conclude that the Commission should adopt the broadest possible unbundling requirements "because access to LEC network elements can only advance and never retard the 1996 Act's objectives in both the short and long terms." AT&T Comments at 21-22.

These contentions are absurd, belied as they are by three years of history. In the eight typical GTE markets studied in the PNR Report, for example, CLECs have deployed fiber networks so ubiquitous that they can reach as many as 97 percent of the addressable business and

[7] *See also* Sprint Comments at 19 ("[E]ven where self-provisioning is a feasible strategy in the long run, it may be necessary to enter the market first using facilities from others for a period of time, while building the customer base needed for economic self-provisioning."); Qwest Comments at 12 ("Qwest submits that the Commission will facilitate efficient facilities deployment if competitors can decide whether to deploy local facilities by first entering markets and serving customers with UNEs.").

residential customers. PNR Report at DFW Metroplex 4. As the following table makes clear, these facilities-based CLECs *do not* use UNEs as a bridge to building new facilities.[8]

TAMPA AREA (GTE Service Territory)			
CLEC	**Bypass**	**Resale Lines**	**UNE Loops**
AT&T	192	33	16
e.spire	1,310	2,940	14
Intermedia	2,000	4,750	
MCI WorldCom	10,117	18	7
Time Warner Telecom	125		
US LEC	74		
WinStar	2,000	9	

Rather, CLECs typically build facilities in target markets based on capital-market-tested business plans *before* attempting to build a customer base in that market. To the extent that a transitional mechanism is required for CLECs to ramp up their service offerings and secure information about market conditions, resale is by far the preferred method. *See* Reply Declaration of Alfred E. Kahn at 4 ("Kahn Reply Declaration") (filed herewith as Appendix A). This fact is confirmed by the experience of AT&T and MCI WorldCom themselves, who together have deployed 12 switches and seven SONET rings used to provide transport and local access in the eight studied GTE markets -- all with little or no reliance on UNE-based service as a getting-started strategy. PNR Report at 30, 72. There is therefore no question -- based on

[8] PNR Report at 14. The column labeled "Bypass" reports the number of lines served by each CLEC without the use of unbundled ILEC elements or resale.

real-world evidence as opposed to speculation -- that the "availability of unbundled network elements at cost-based rates" is *not* a "necessary precondition" to the construction of new facilities. MCI WorldCom Comments at 8.

The Big Three likewise argue that overbroad unbundling rules will not deter CLECs from deploying facilities because no "rational company would pursue a business strategy that makes it dependent on the long-term cooperation of a single dominant rival." *Id.* at 26; *see also* Sprint Comments at 19 ("[A]ny carrier desiring a significant market presence over the long term must consider self-provisioning as the most desirable business strategy -- indeed, the only strategy that can ensure that a carrier is the master of its own fate."). These assertions are directly contradicted by the Big Three's own comments, which make it clear that they would be happy to provide mass market service indefinitely relying solely on unbundled ILEC elements. One rationale offered by the Big Three for why the Commission should require ILECs to provide the UNE Platform is that it is "indispensable to permit competition in those areas of the country where alternative facilities will *never* be feasible." AT&T Comments at 23. Nevertheless, AT&T promises that the UNE Platform will bring "the immediate development of mass market competition" in these markets. *Id.* at 2. It is therefore clear that CLECs would be *perfectly content* to provide UNE-based service purchased at TELRIC prices even in markets where they have no plans to deploy facilities.

Given this fact, it is absurd to contend, as do the Big Three, that granting CLECs the ability to rely on the UNE Platform will not discourage them from building their own facilities. The primary commenters supporting the Platform -- long distance companies like the Big Three and a trade organization representing IXCs with few of their own facilities -- have no incentive to see the Commission adopt rules that will promote facilities-based competition.[9] Existing facilities-based CLECs, on the other hand, do not support requiring ILECs to provide a pre-assembled UNE Platform at TELRIC prices. Unlike the Big Three -- who have every incentive to *slow* the pace of local competition to protect their core long distance business from RBOC competition -- facilities-based CLECs stand to lose billions of dollars of invested capital if competitors are able to undercut their prices *without* making any of their own investments. Thus, Cox Communications concludes that, given the Act's goal of "fostering facilities-based competition," Congress "did not intend that nonproprietary UNEs at any level of granularity be made readily available to all comers." Cox Comments at 25. Likewise, facilities-based Focal Communications concludes that the Commission cannot make the UNE Platform available "at TELRIC" without undermining the core purpose of the Act. Focal Comments at 5.

These CLECs recognize what Professor Kahn made explicit -- that "the mandatory offer of an entire 'platform' deters facilities-based competition across the board." Kahn Declaration

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[9] Given that AT&T is now implementing a multi-billion dollar cable-based strategy for local entry, its effort to reinstate a "soup to nuts" blanket unbundling requirement can only be intended to achieve one goal -- undermining ILEC investment in traditional wireline telephone networks. Why else would a competitor like AT&T that has chosen to invest heavily in its own alternative networks wish to advocate a rule that is designed to serve CLECs who do not have their own facilities? After all, AT&T well recognizes that a sharing obligation undermines the investment incentives of the incumbent. Thus, when it was recently suggested that the AT&T-TCI cable networks should be subject to parallel unbundling and resale obligations, AT&T Chairman C. Michael Armstrong protested that "[n]o company will invest billions of dollars to become a facilities-based broadband services provider if competitors who have not invested a penny of capital, nor taken an ounce of risk, can come along and get a free ride on the investments and risks of others." Armstrong Fires Back at Critics of TCI Deal, TR Daily.

at 8. Because the Supreme Court made clear that CLECs are only entitled to the UNE Platform if every element in the Platform meets the section 351(d)(2) standard, *Iowa Utils. Bd.,* 119 S. Ct. at 737, and because numerous elements like switching, signaling, and OS/DA fail this test, the Commission cannot require ILECs to offer unbundled Platform access.

B. Relevant Competition Law Principles Dictate that an Element Will Meet the "Impair" Test Only If It Is Essential To Competition and There Is Convincing Evidence That CLECs Cannot Effectively Compete Using Substitutes for the Element.

None of the commenters supporting expansive unbundling requirements deny the Supreme Court's oft-repeated conclusion that Congress is "presumed to intend" the "judicially settled meaning" of terms or concepts used in a statute,[10] and that any reasonable method of statutory construction "must take into account" the "contemporary legal context" in which a statute is enacted.[11] Likewise, these commenters identify no other rule within the Act's "contemporary legal context," apart from the essential facilities doctrine, that is analogous to section 251(d)(2)'s requirement that ILECs share certain facilities with competitors. Although it is clear that the Act does not require the Commission to apply every element of the judicial essential facilities doctrine, it is equally clear that the principles underlying this doctrine --

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[10] *American Nat'l Red Cross v. S.G. & A.E.*, 505 U.S. 247, 252 (1992); *see also Traynor v. Turnage*, 485 U.S. 535, 546 (1988); *Director, Office of Workers Compensation Programs v. Perini North River Assoc.*, 459 U.S. 297, 319-20 (1983).

[11] *Cannon v. University of Chicago*, 441 U.S. 677, 698-99 (1979); *see also id.* at 699 (Court presumes "that Congress was thoroughly familiar with . . . important precedents from [the Supreme Court] and other federal courts and that it expected its enactment to be interpreted in conformity with them"); *Morse v. Republican Party of Va.*, 517 U.S. 186, 230-31 (1996) (interpreter of statute must look to "'backdrop' of decisions" against which "Congress acted").

which, like the Act, are designed to promote competition -- should guide the Commission's interpretation of section 251(d)(2).

This fact is confirmed by the Act's legislative history. Congress expressly stated that the Act's rules were designed to eliminate ILECs' "bottleneck control over the essential facilities needed for the provision of local telephone service." H.R. Rep. No. 104-204, at 49 (1995). The only statement the Big Three could find that discusses the essential facilities doctrine -- identified by MCI WorldCom at 35-36 -- *wholly supports* the Commission's use of the competition principles underlying the doctrine to interpret section 251(d)(2). A 1994 House version of the Act required ILECs to "offer unbundled features, functions, or capabilities whenever technically feasible and economically reasonable," and contained no analog to section 251(d)(2)'s "necessary" and "impair" standards. H.R. Res. 3636, 103d Cong. § 102(c)(1)(B)(ii) (1994). Criticizing this open-ended approach to unbundling -- the same approach proffered by the Big Three here -- Rep. Crapo of Idaho stated that if "our *objective is competition*, interconnection ought to be *restricted to essential facilities*" and should not be expanded so broadly as to allow "new communications entrants to piecepart the public network at their whim." 140 Cong. Rec. H5216, H5243 (daily ed. June 28, 1994) (emphasis added). There is no dispute that the Act's objective is -- as Rep. Crapo stated -- to promote competition. The legislative history therefore speaks with a uniform voice in favor of interpreting section 251(d)(2) in light of the competition principles underlying the essential facilities doctrine.

The Big Three and other commenters miss the point of using the *principles* underlying the essential facilities doctrine -- and not the judicially applied doctrine itself -- to interpret section 251(d)(2)'s unbundling requirements. Competition law limits the compelled sharing of facilities to circumstances when firms cannot compete effectively without access because sharing requirements significantly diminish the incentives for competitors and incumbents to innovate and invest in their own facilities. It is irrelevant that the "essential facilities doctrine does not apply to circumstances in which the law seeks to eliminate an existing monopoly,"[12] that the "Act does not refer to 'essential facilities,'"[13] or that the purpose of the Act generally "is more aggressive than the objective of the antitrust laws."[14] The Act does not require the Commission to apply every element of the essential facilities doctrine as would a court. As MCI WorldCom itself states, a CLEC is neither required to prove that an ILEC "'willfully maintained' or acquired a monopoly" to establish its right to purchase unbundled ILEC elements. MCI WorldCom Comments at 33. By imposing a statutory unbundling obligation in section 251, the

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[12] AT&T Comments at 12.

[13] *Id.* at 48; *see also* Sprint Comments at 14; ALTS Comments at 32-33.

[14] AT&T Comments at 49; *see also* Sprint Comments at 15 ("The antitrust milieu is far different than the pro-active framework of § 251."); MCI WorldCom Comments ("[T]he "Act goes much further, and imposes affirmative market-opening requirements, irrespective of whether ILECs could be shown to have willfully maintained a monopoly in the past or whether they are willfully maintaining a monopoly now.").

Act obviates any need for the Commission to apply these exclusionary conduct elements of the essential facilities doctrine.[15]

But the Act does not obviate the need for the Commission to guarantee that CLEC and ILEC incentives to invest in facilities are not diluted by extending unbundling obligations to elements for which substitutes are readily available in the marketplace.[16] Indeed, the Act commends precisely the opposite result. Following these governing principles, the Commission should rule that "the failure to provide access" to any particular network element would "impair" CLECs' ability to provide service within the meaning of section 251(d)(2)(B) only where the element in question is essential to competition and there is convincing evidence that CLECs cannot effectively compete using substitutes for the element.

The alternative formulations of the "impair" test proffered by the Big Three and others cannot be squared either with the plain terms of section 251(d)(2) or with the Act's purpose of promoting competition. *First*, AT&T suggests that the Commission can simply reinstate its old interpretation of section 251(d)(2)'s "impair" test and require ILECs to provide unbundled

[15] The fact that Congress included an antitrust savings clause in the Act therefore does not, as asserted by MCI WorldCom and others, suggest that Congress "was granting new rights and remedies under the Act, not merely codifying previously existing ones." MCI WorldCom Comments at 32; *see also* Sprint Comments at 14. Because section 251(d)(2) is not coterminous with the judicially applied essential facilities doctrine, the Act's antitrust savings clause does not create any remedies duplicative of those granted by the Sherman Act.

[16] MCI WorldCom's statement that the Act omits a requirement -- contained in an earlier version of the statute -- that only LECs with "market power" be subject to unbundling obligations says nothing about whether the Commission should interpret section 251(d)(2) in light of the competition principles underlying the essential facilities doctrine. MCI WorldCom Comments at 36.

access to an element whenever CLECs relying on substitutes would bear "any increase" in cost. Despite the fact that this very same articulation of "impair" was rejected by the Court as being "simply not in accord with the ordinary and fair meaning" of the Act, AT&T contends that a CLEC "cannot anticipate 'handsome' -- or indeed any -- profits if it is forced to incur higher costs (or provide a more limited or lower quality service) because it is required to obtain one or more elements through self-provisioning or sources other than the LECs." AT&T Comments at 8. Thus, according to AT&T, "under current market conditions, 'any increase' in the costs to provide service incurred by CLECs that lease network elements will impair their ability to provide service." *Id.* at 35.

This interpretation of the Act -- even if it were not expressly foreclosed by the Supreme Court's decision -- simply cannot be squared with the facts. As Chairman Kennard noted, there are "10 publicly traded CLECs with a total market capitalization of $33 billion."[17] The capital markets would not be so solicitous of these companies if their prospects for success could be destroyed by an insignificant cost increase. Likewise, the factual record is replete with evidence that CLECs are experiencing extraordinary revenue growth. Taking just one example of a facilities-based CLEC operating extensively in GTE's territory, e.spire, which earned only $0.3 million in revenues in 1995, collected $156.7 million in 1998 (an increase of 12,967 percent) and earned $58.1 million in the first quarter of 1999. NECI Report at 22. Numerous other CLECs

[17] Oral Testimony of William E. Kennard Before the Senate Commerce Committee, at 2 (May 26, 1999).

are experiencing similar revenue growth -- belying AT&T's ludicrous assertion that any increase in cost could "impair" these competitors's ability to compete.

Second, MCI WorldCom and others argue that a CLEC is impaired if its "ability to offer service is materially diminished" by denial of access to an unbundled element. MCI WorldCom Comments at i; *see also* Sprint Comments at 10-11; ALTS Comments at i. Although this standard sounds more stringent than that proposed by AT&T, in fact it is not. Thus, MCI WorldCom suggests that its formulation of the "impair" test will be met if an element's unavailability: (i) "threatens the ability of a CLEC to earn a reasonable return on capital . . . for any class of customers or in any geographic area"; (ii) "if lack of access to an element precludes CLECs from offering a single "feature" or "capability"; or (iii) "if lack of access would delay" -- by as little as one day -- "CLECs' ability to provide service to any class of customers or any geographic area." MCI WorldCom Comments at 18. Again, the marketplace evidence confirms that CLECs are successfully competing using substitutes for ILEC elements, even when they have to bear these *de minimis* costs.

Third, Sprint claims that section 251(d)(2) applies, in its entirety, only to proprietary elements and that the Commission should not apply the "impair" test to any elements without proprietary protocols. Sprint Comments at 11. Thus, under Sprint's interpretation, "if access is denied because the UNE is not 'necessary,' § 251(d)(2)(B) requires that the Commission consider whether reliance on an alterative would 'impair' the requesting carrier's ability to provide" service. *Id.* at 11-12. Sprint contends that this interpretation of the Act is the only one that can be reconciled with section 251(c)(3)'s "broad duty to provide UNEs to 'any requesting carrier.'" *Id.* at 12. But this position -- which the Commission rejected in the *First Report and Order* -- does not reasonably interpret the phrase "such network elements" in section 251(d)(2)(B), which plainly refers back to the general antecedent phrase "what network elements should be made available" in the opening sentence of section 251(d)(2). Nor does section 251(c)(3) provide any support for Sprint's interpretation. That section, as the Supreme Court concluded, only "indicates where unbundled access must occur, not which [network] elements must be unbundled." *Iowa Utils. Bd.*, 119 S. Ct. at 736. The Commission would therefore have no basis to conclude, as Sprint urges, that its discretion to require unbundled access to nonproprietary ILEC elements is entirely unfettered.

Finally, Qwest proposes a formulation of the "impair" test that requires ILECs to continue providing unbundled access to an element until "a sufficient number of wholesale vendors . . . produce effective wholesale competition for" the element. Qwest Comments at 16 (emphasis omitted). Thus, according to Qwest, the "fact that some CLECs today are engaging in self-supply of network elements is . . . not evidence of lack of impairment." *Id.* at 18. This formulation of the "impair" test is absurd given that CLECs in every kind of market are self-providing their own substitute elements. In the eight GTE territories studied by PNR, for example, every facilities-based CLEC self-provides switching and numerous CLECs self-provide transport, operator services and directory assistance, signaling, and loops. Exempting these CLECs from the "impair" calculus would not be faithful to the Supreme Court's command that the Commission take account of the "availability of elements outside the incumbent's network." *Iowa Utils. Bd.*, 119 S. Ct. at 735. Moreover, such a rule would destroy any incentive for CLECs to self-provide elements and would disadvantage CLECs that already have facilities in place. Qwest's "wholesale market" interpretation of "impair" therefore cannot be squared with either the text or purpose of section 251(d)(2).

The Big Three and other commenters also attempt to circumvent the force of section 251(d)(2)'s "impair" test by suggesting that the "Commission is free to identify and give appropriate weight to other factors as it sees fit" and that "lack of impairment . . . does not automatically mean that ILECs have a right to deny access" to a particular element. MCI WorldCom Comments at 22.[18] These assertions are supported by citations to court of appeals cases suggesting that the Commission, when generally charged with "considering" a factor, is not required "to give any specific weight to it." AT&T Comments at 37 (quoting *Time Warner Entertainment Co. v. FCC*, 56 F.3d 151, 175 (D.C. Cir. 1995)).

But here the Supreme Court expressly instructed the Commission to "giv[e] some substance to the 'necessary' and 'impair' requirements" in determining which elements must be unbundled. *Iowa Utils. Bd.*, 119 S. Ct. at 736. Interpreting the Act in a way that disregards these standards cannot be squared with the Court's command or the plain meaning of the phrase "at a minimum" in section 251(d)(2). By requiring the Commission to consider *at a minimum* the "necessary" and "impair" standards when determining which elements to unbundle, section 251(d)(2) expressly sets out baseline criteria that must be satisfied before a sharing

[18] *See also* AT&T Comments at 37 (Commission "may choose to give" the section 251(d)(2) factors "weight, but it is not required to give them any weight at all"); Sprint Comments at 26 ("As long as the Commission gives due consideration to the necessary and impair clauses, it need not attempt to attach any specific weight to those requirements.").

obligation can be imposed. It also gives the Commission authority to consider *additional* factors when making this determination, and to refrain from imposing unbundling obligations on elements that satisfy the "necessary" and "impair" standards -- but only if doing so would serve the objective of competition. Any rule predicated on the assumption that these standards could be disregarded would have the opposite effect; it would drain the "necessary" and "impair" requirements of their substance.

The Commission therefore cannot base its unbundling rules on any of the additional factors suggested by the Big Three. AT&T, for example, asserts that the Commission should require ILECs to unbundle elements that do not satisfy the "impair" test if "any increase in the cost of service or decrease in its quality or scope" results from CLECs' use of a substitute. AT&T Comments at 9. But the Supreme Court's mandate cannot be so easily evaded. The Court squarely held that unbundling requirements predicated on so low a threshold are "not in accord with the ordinary and fair meaning" of section 251(d)(2), *Iowa Utils. Bd.*, 119 S. Ct. at 735 -- a decision that cannot be circumvented by AT&T's assertion that the word "consider" gives the Commission discretion to ignore the plain language of the Act.

Likewise, the Commission should reject MCI WorldCom's suggestion that ILECs can be ordered to unbundle elements that do not satisfy the "impair" test if doing so would allow CLECs to "provide ubiquitous service" or serve "all categories of customers." MCI WorldCom Comments at 23-24. These goals will already be served if the Commission establishes unbundling rules that reflect actual marketplace realities and differentiate -- as CLECs in the market currently do -- between elements that serve customers of different sizes. Moreover, the

Commission should reject MCI WorldCom's request that ILECs be made to unbundle elements that do not meet the "impair" test in order to "jumpstart local competition." *Id.* at 24. As Professor Kahn makes clear, overbroad unbundling rules destroy, not jumpstart, competition by eliminating any incentive CLECs have to deploy their own facilities. *See* Kahn Declaration at 6. The Commission therefore cannot "consider" this additional factor without contravening the text and purpose of section 251(d)(2).

Finally, the Big Three contend that the Commission should require ILECs to provide unbundled access to elements identified in the section 271 checklist even if those elements fail to satisfy the "impair" test. MCI WorldCom Comments at 23; Sprint Comments at 27. But it would violate the substantive requirements of section 251(d)(2) to impose unbundling obligations on non-BOC ILECs, like GTE, by virtue of the checklist requirements that apply only to BOCs under section 271. Moreover, the fact that Congress more than three years ago included certain elements in the section 271 competitive checklist says nothing about whether CLECs can *currently* compete effectively without access to those elements. Neither Congress -- nor the Court, which instructed the Commission to make a timely examination of the availability of substitutes outside ILECs' networks -- believe that section 271's checklist should supersede the Act's purpose of promoting competition and the plain text of section 251(d)(2).

C. The Commission's Unbundling Requirements Must Be Tailored To Match Differences in the Availability of Substitutes in Particular Geographic Markets.

Application of the "impair" standard to particular elements must be tailored to accommodate differences in the availability of substitutes within the relevant geographic market for each network element. Before the Commission requires an element to be unbundled, it therefore must determine the proper scope of the geographic market for that element, and it should impose an unbundling obligation only in those markets where the ILEC's network element is the only reasonable alternative available to competitors. The Supreme Court's remand order made this requirement explicit by instructing the Commission to adopt rules that reflect the "availability of elements outside the incumbent's network." *Iowa Utils. Bd.*, 119 S. Ct. at 735. Because the geographic scope for the available supply and use of substitutes necessarily differs by element, the Commission may not adopt a single uniform "one size fits all" national unbundling requirement that ignores relevant market differences.

The need for the Commission's rules to reflect these differences in geographic markets is demonstrated by the comments of numerous state commissions, who have spent the past three years collecting and reviewing factual evidence on the availability of alternatives to ILEC elements in different geographic markets. Based on a review of this evidence, the Texas PUC counsels the Commission that the "availability of network elements from sources other than the ILEC varies quite significantly, depending on the particular element sought and the location of the element." Texas PUC Comments at 13. Likewise, the Florida PSC states that the "availability of UNEs from providers other than ILECs is likely to vary considerably both within a state as well as among states," and that "an impairment analysis must take into consideration whether viable facilities-based providers of network functionalities and components, other than the incumbent LECs, exist in a specific geographic locale." Florida PSC Comments at 6-7. The

Ohio PUC agrees, stating that the analysis required by section 251(d)(2) is "largely fact-intensive or specific to a particular geographic region or market." Ohio PUC Comments at 21.

The Big Three attempt to dissuade the Commission from taking proper account of these differences in geographic markets by suggesting that "the availability of usable alternatives throughout the country spans only the narrow range between very slight and none." AT&T Comments at 45. "As a consequence," the Big Three conclude, the "localized analyses that the LECs seek to require would, if concluded correctly, lead at this time to a nationally uniform result in any event." *Id*; *see also* Sprint Comments at 8 ("[C]ompetition today is in such a state of infancy that it is fruitless to consider, at this time, any form of geographic differentiation in the baseline set of elements.").[19] These assertions cannot be squared with the facts. As exhaustively detailed by the UNE Fact Report, the PNR Report, and the NECI Report, substitutes for unbundled ILEC elements are widely used in every kind of geographic market, with substitutes for transport and loops currently available primarily in densely populated areas.

The Commission can develop rules that take account of these differences without conducting an individualized adjudication into the conditions prevailing in every geographic market. For switching, operator services and directory assistance, and signaling, competitive alternatives are available on a national basis such that these elements should not be subject to unbundling. For transport and loops, the Commission can readily adopt workable standards --

[19] ALTS likewise argues that "[n]ational minimum unbundling standards remain the most efficient way to spur widespread development of local competition," and asserts that the Commission should not take account of any differences in geographic markets until "after an initial two year gestation period." ALTS Comments at 4, 8.

wire centers with 15,000 or more lines for transport, and customers with 20 or more lines for loops -- that reflect the availability and use of competitive substitutes in the marketplace. These rules will be national in their application and will therefore afford all of the predictability required for CLECs "to formulate and execute national business plans to offer local service." MCI WorldCom Comments at ii. Moreover, these rules will guarantee that competition is not stifled in areas where competitive substitutes are available -- a result that cannot be squared with section 251(d)(2) or the Supreme Court's mandate. As MCI WorldCom concedes, an unbundling "rule that generally leads to the correct result and does so without any delay or confusion is far superior to a rule designed to respond to the infrequent case." *Id.* at 10.

Commenters have suggested three different approaches the Commission might adopt that would fail to account for important differences among geographic markets. *First*, the state commissions advocate a regime that allows the states to add or subtract elements from the Commission's unbundling requirements.[20] Section 251(d)(2) expressly tasks the *Commission* "to determine" -- after applying the "necessary" and "impair" standards -- which ILEC elements should be unbundled. The limits these standards impose on ILEC unbundling obligations cannot be ignored or supplemented without harming competition. Because section 251(d)(3) expressly provides that states cannot adopt mandates inconsistent with section 251(d)(2) or the Act's procompetitive "purposes," the Commission should reject any suggestion that the states have authority to predicate additional unbundling obligations on the dictates of state or federal law.

[20] *See* Texas PUC Comments at 3; California PUC Comments at 7-11; Florida PSC Comments at 7-8; Ohio PUC Comments at 7.

As Justice Breyer concluded, "the statute's unbundling requirements, read in light of the Act's basic purposes, require balance." *Iowa Utils. Bd.*, 119 S. Ct. at 754 (Breyer, J., concurring in part and dissenting in part). This balance struck by Congress in section 251(d)(2)'s "necessary" and "impair" standards could only be frustrated by a state's efforts to expand or contract the Act's unbundling obligations.

Second, AT&T asserts that a CLEC is impaired in its ability to offer service if an alternative will not allow it "to provide mass-based residential service." AT&T Comments at 29; *see also* Competitive Telecommunications Ass'n Comments at 28 ("[T]he requesting carrier should be presumed to be attempting to enter the market on both a business and residential basis."). It likewise claims that GTE has "turn[ed] the statute on its head" by suggesting that the Commission should consider -- in determining that CLECs are impaired without access to an element -- that "CLECs effectively compete by initially targeting business centers or pockets of high-value customers." AT&T Comments at 29. AT&T characterizes this as an "admission that broad scale mass market competition will not occur today in the absence of network elements." AT&T Comments at 29-30.

But the real reason why competition has not developed as quickly in the residential market is that state regimes of implicit universal service subsidies keep retail rates for residential customers below cost. And in any event, the Commission can easily adopt unbundling rules that accurately take account of the differences between substitutes used to serve large business customers and small mass market customers. GTE's proposed loop unbundling rule is a perfect example, because it allows the Commission to safeguard incentives for carriers to deploy loop alternatives to businesses and MDUs with more than 20 lines while recognizing that such alternatives are not yet viable for mass market customers. This threshold reflects both engineering and marketplace realities. For traditional wireline CLECs, 20 lines is generally the point where a business customer or MDU can be served by a DS1 line that can readily be dropped from a CLEC SONET ring and provisioned at a much lower cost than 20 separate lines. NECI Report at 34-35. Likewise, fixed wireless networks are ideally suited to serve customers or MDUs requiring DS1 capacity or greater. CLECs operating in the marketplace clearly recognize this distinction, as numerous wireline and fixed wireless CLECs are providing service to business and MDU customers with 20 or more lines using self-provided or wholesale-purchased alternatives to unbundled ILEC loops. *See* GTE Comments at 66, 70. The Commission therefore should not heed AT&T's request that it bootstrap the availability of elements serving large customers -- for which substitutes are widely in use by highly capitalized CLECs -- on the nascency of facilities-based competition for mass-market customers. Such a rule would not be true to the Court's instruction that the Commission consider "the availability of elements outside the incumbent's network," *Iowa Utils. Bd.*, 119 S. Ct. at 735, to the text of section 251(d)(2), or to the Act's procompetitive purpose.

Finally, AT&T, Sprint, and Qwest assert that section 251(c)(3) precludes the Commission from differentiating in its unbundling rules between elements that serve different types of customers. These commenters conclude that section 251(c)(3)'s requirement that ILECs make elements available "to any requesting carrier for the provision of a telecommunications service" precludes the Commission from adopting rules that allow elements "to be used to provide service